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JAPAN ECONOMIC INSTITUTE

JEI REPORT

NO. 12B
March 28, 1986

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Japan's Economy Surges Ahead In Fourth Quarter

Continued strong growth in business investment and a recovery in residential construction led to a sharp expansion in Japan's economy in the October-December period. The increase in gross national product at an inflation-adjusted annual rate of 7.2 percent, compared to 3 percent in the preceding three months (see Table), surprised many economists. Calendar year 1985 growth registered 4.6 percent, a modest slowdown from 1984's 5.1 percent rate.

Private investment increased at double-digit rates for the third consecutive quarter, led by the nonmanufacturing sector. Plant and equipment

outlays by manufacturers slowed, though, reflecting the downward trend in export shipments. Measures to increase home purchases in last October's demand stimulation package (see JEI Report No. 40B, October 18, 1985) encouraged the 9.1 percent rise in residential construction, as housing starts increased each month during 1985's final quarter.

The economy's impressive growth occurred despite the second consecutive quarterly drop in exports. The decline reflected the fall in the yen value of shipments to the United States and China. The external sector, however, made a net positive contribution to growth of about 1 percentage point, as the fall in imports exceeded that of exports.

Personal consumption continued to increase at a sluggish pace, rising just 2.2 percent, because of modest income gains. The increase in income was only 2.8 percent in real terms compared to year-earlier levels. During the past seven quarters, the rise in consumer spending has exceeded 2.2 percent only once.

It is not anticipated that growth in the coming months will match the impressive fourth-quarter results. Most exports for the October-December period were contracted prior to the sharp appreciation of the yen that began in late September. Bigger declines in shipments are expected as the export volume responds to the higher yen. Industrial production was down 3 percent in the last three months of 1985, and the Economic Planning Agency predicts another 0.2 percent fall in the January-March quarter. This would mark the first time production has fallen three consecutive quarters since the 1973 oil crisis. The government plans to announce a package of measures to stimulate domestic demand prior to Prime Minister Yasuhiro Nakasone's departure for Washington on April 12.

The pace of personal consumption expenditures, which accounts for over one-half of GNP, will play a major role in determining whether the current expansion continues. In the six months following the 1978 appreciation of the yen, consumption increased at an inflation-adjusted annual rate of 7.5 percent. Despite a slight drop in the growth of nominal income from fiscal 1977 to fiscal 1978, the fall in the inflation rate from 6.8 percent to 3.4 percent boosted real income and consumer spending.

It is unclear, though, whether the recent appreciation of the yen will lead to an equally sharp dip in the inflation rate. In December the government predicted that the rise in the consumer price index would fall from an already low 2.1 percent in FY 1985 to 1.9 percent in FY 1986. Furthermore, the prospects for wage increases are uncertain. While the unions are pushing for at least a 7 percent hike during the annual spring wage bargaining, the chairman of the Japan Federation of Employers' Associations, Bunpei Ohtsuki, has argued for a 3 percent rise. Forecasters such as Nihon Keizai Shimbun and Nomura Research Institute expect a 4.5 to 4.8 percent increase, which would be less than last year's 5 percent rise.

This year, though, the government has clearly indicated its support for a large wage increase to stimulate domestic demand. The prime minister's Industrial Structure Council recently noted that "both nominal and real wage increases in 1983 and 1984 trailed the rise in productivity," and called for a larger share of national income for wages.

Randall S. Jones

Japan's Real Gross National Product at Constant (1980) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	1984	1985	January-March 1985	April-June 1985	July-September 1985	October-December 1985
Gross National Product	¥278,118.6 (5.1%)	¥291,039.3 (4.6%)	¥285,425.7 (1.7%)	¥289,447.6 (5.8%)	¥291,588.4 (3.0%)	¥296,667.1 (7.2%)
Personal Consumption Spending	158,124.5 (2.8%)	162,439.9 (2.7%)	161,106.4 (4.8%)	161,900.4 (2.0%)	162,777.8 (2.2%)	163,650.2 (2.2%)
Private Residential Construction	13,619.1 (-2.1%)	14,056.2 (3.2%)	13,913.9 (5.1%)	14,227.9 (9.3%)	13,881.0 (-9.4%)	14,186.5 (9.1%)
Private Fixed Nonresidential Investment	46,277.4 (10.9%)	52,114.8 (12.6%)	48,574.5 (1.0%)	51,124.5 (22.7%)	53,189.7 (17.2%)	55,300.4 (16.8%)
Change in Business Inventories	1,609.6 (102.3%)	1,812.7 (12.6%)	2,112.0 (37.4%)	1,825.3 (-44.2%)	1,438.2 (-61.4%)	1,882.1 (193.3%)
Government Current Expenditures	26,471.3 (2.5%)	27,146.9 (2.6%)	26,979.1 (4.6%)	27,081.5 (1.5%)	27,192.9 (1.7%)	27,342.9 (2.2%)
Government Fixed Investment	22,374.4 (-2.9%)	20,831.2 (-6.9%)	21,615.5 (-7.1%)	19,954.0 (-27.4%)	20,495.6 (11.3%)	20,917.3 (8.5%)
Change in Government Inventories	162.8 (*)	305.9 (*)	27.9 (*)	77.6 (*)	515.6 (*)	604.7 (*)
Net External Sector	9,479.7 (59.3%)	12,331.7 (30.1%)	11,096.4 (-29.2%)	13,256.4 (103.7%)	12,097.6 (-30.6%)	12,783.0 (24.7%)
Exports of Goods and Services and Factor Income Received	52,365.0 (17.5%)	55,446.5 (5.9%)	54,833.7 (-3.0%)	57,176.9 (18.2%)	55,077.6 (-13.9%)	54,654.4 (-3.0%)
Imports of Goods and Services and Factor Income Paid	42,885.3 (11.1%)	43,114.9 (0.5%)	43,737.3 (5.5%)	43,920.5 (1.7%)	42,980.0 (-8.3%)	41,871.4 (-9.9%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency